CHAPTER 3

Admission of a Partner

MEANING OF KEY TERMS USED IN THE CHAPTER

1. Admission of Partner or Partners

Admission of a Partner or partners means new partner or partners being admitted into partnership.

2. New Profit-sharing Ratio

New Profit-sharing Ratio is the ratio in which all the partners or partners including the new or incoming partner or partners share future profits and losses of the firm.

3. Sacrificing Ratio

Sacrificing Ratio is the ratio in which the old or existing partners forego, *i.e.*, sacrifice their share in favour of the new partner or partners.

4. Goodwill

Goodwill is an intangible asset resulting from the efforts made in the past by the existing partners of the firm which results in profits in the future years.

5. Revaluation of Assets

Revaluation of Assets means change in the value of assets, *i.e.*, present value being different from the book value of the assets.

6. Reassessment of Liabilities

Reassessment of Liabilities means reassessing the liabilities and determining the change, *i.e.*, whether the liability is more or less than that shown in the books of account.

7. Revaluation Account

It is a nominal account, prepared to ascertain gain (profit)/loss on account of revaluation of assets and reassessment of liabilities. It is credited with the increase in value of assets and decrease in the value of liabilities. It is debited with the increase the value of liabilities and decrease in the value of assets. It is closed by transferring the gain (profit) or loss to the Capital Accounts or Current Accounts of the old or existing partners in their old profit-sharing ratio.

8. Reserve

Reserve means accumulated or undistributed profits. It is created out of profits.

The reserve created is sometimes invested outside the business in instruments such as securities, which then becomes a *Reserve Fund*.

9. Workmen Compensation Reserve

It is a reserve created out of profits for payment of compensation to workers.

10. Investments Fluctuation Reserve

It is a reserve created out of profits to meet the fall in the market value of investment.

SUMMARY OF THE CHAPTER

- When the existing partners of a firm allow a person to become a partner in the firm, it is called **admission of a partner**.
- The matters that require *adjustment* at the time of admission of a new partner are:
  (*i*) Adjustment for change in Profit-Sharing Ratio. Calculation of New Profit-sharing Ratio and Sacrificing Ratio.
  (*ii*) Adjustment for goodwill.
  (*iii*) Adjustment of Profit/Loss arising from the Revaluation of Assets and Reassessment of Liabilities.
  (*iv*) Adjustment of Accumulated Profits, Reserves and Losses.
  (*v*) Adjustment of Capital.
- Change in Profit-sharing Ratio takes place at the time of admission of a new partner in the firm.
- The ratio in which all partners including the incoming partner share the future profits and losses is known as **New Profit-Sharing Ratio**.

  Unless agreed otherwise, the **New Profit-sharing Ratio** *of existing, i.e., old partners among them will be same as their old profit-sharing ratio.*
- The ratio in which the old (existing) partners have agreed to sacrifice their share in profit in favour of an incoming partner is called **Sacrificing Ratio**.

  Sacrificing Share = Old Share – New Share.

  Unless agreed otherwise, **Sacrificing Ratio** *of old partners will be the same as their old profit-sharing ratio.*
- The partners whose share in profit increase due to change in profit-sharing ratio are called *Gaining Partners* and the partners whose share in profit decrease are called *Sacrificing Partners*.
- **Goodwill** is the reputation of the organisation which attracts customers and increases the profit earning capacity of the business.

ACCOUNTING TREATMENT OF GOODWILL ON ADMISSION OF A PARTNER

1. *Goodwill (Premium) paid Privately*	No Entry	
2. *Goodwill brought in Cash*	Cash/Bank A/c To Premium for Goodwill A/c	...Dr.
Distribution of Goodwill	Premium for Goodwill A/c To Sacrificing Partners' Capital A/cs or To Sacrificing Partners' Current A/cs (When capitals are fixed)	...Dr. [In sacrificing ratio]
3. *Goodwill withdrawn by Sacrificing (Old) Partners*	Sacrificing Partners' Capital A/cs To Cash/Bank A/c	...Dr.
4. *Goodwill not brought in Cash*	New Partner's Current A/c To Sacrificing Partners' Capital A/cs	...Dr. [In sacrificing ratio]
5. *Goodwill brought in Kind*	Assets A/c To Premium for Goodwill A/c	...Dr.

Note: *Write off the goodwill appearing in the Old Balance Sheet by debiting the Old Partners' Capital Accounts (in case of fluctuating capitals) or Current Accounts (in case of fixed capitals) in their old profit-sharing ratio and crediting the Goodwill Account.*

- **Unless otherwise stated, the Partners' Capitals should be assumed to be fluctuating. Current Accounts are to be used in case of Fixed Capitals**.
- **When the incoming partner cannot bring premium for goodwill in cash**, adjustments are to be done through the **Current Account** of Incoming Partner.

- **Revaluation Account or Profit and Loss Adjustment Account** is prepared to revalue the assets and reassess the liabilities of the firm at the time of reconstitution of the firm.

Dr. REVALUATION ACCOUNT *Cr.*

(i) Decrease in the value of assets.	Increase in the value of assets.
(ii) Increase in amount of liabilities.	Decrease in amount of liabilities.
(iii) Unrecorded liabilities.	Unrecorded assets.
(iv) Gain (Profit)—difference.	Loss—difference.

- **Need to Revalue Assets and Reassess Liabilities:** Assets are revalued and liabilities are reassessed at the time of admission of a partner because new partner should neither benefit nor suffer because of changes in the value of assets and liabilities as on the date of admission.
- **Any Past Profits** or **General Reserve** are also credited to Old Partners' Capital Accounts in their profit-sharing ratio. If there are any past losses, they will be debited to Old Partners' Capital Accounts.
- **Workmen Compensation Reserve** is a reserve created out of profit to meet the workmen compensaton claim, if any arise in future. *Excess of Workmen Compensation Reserve over the Workmen Compensation Claim should be credited to old partners' Capital Accounts in their old ratio.*
- **Investments Fluctuation Reserve** is created out of profit to guard against the fall in the price of the investment. *Excess of Investment Fluctuation Reserve over difference between book value and market value should be credited to old partners in their old profit sharing ratio.*
- Accounting Treatment of Accumulated Profits, Reserves and Losses through Single Journal Entry: *The net effect of accumulated profits, reserves and losses is adjusted through the following entry:*

  (*i*) **In Case of Net Profit:** Gaining Partners' Capital/Current A/cs ...Dr.
  To Sacrificing Partners' Capital/Current A/cs

  (*ii*) **In Case of Net Loss:** Sacrificing Partners' Capital/Current A/cs ...Dr.
  To Gaining Partners' Capital/Current A/cs

Note: Adjustment of the incoming partner's share to be made through his Current Account, similar to the treatment of goodwill not brought in cash.

- **Employees' Provident Fund** is a statutory liability. Hence, is **not distributed** among the partners.
- **Adjustment of Capital:**

  (*i*) *Adjustment of Old Partners' Capitals on the basis of New Partner's Capital:*
  Step 1: Calculate the total capital of the new firm.
  Step 2: Determine the new capital of each partner.
  Step 3: Ascertain the present capitals of old partners (Adjusted).
  Step 4: Find out the surplus/deficit capitals by comparing Step 2 and Step 3.

  (*ii*) *Calculation of the New Partner's Capital on the basis of Old Partners' Capitals:*
  Step 1: Determine the total adjusted capital of the old partners.
  Step 2: Determine the total capital of the new firm.
  Step 3: Determine the total capital of the incoming partner as follows:
  Total capital of the new firm (Step 2) × Share of incoming partner.

  In the absence of any contract, **Shortage** or **Surplus of Capital** *should be adjusted in* **Cash** *and not by transfer to Current Account.*

Solved Questions

Illustration 1.

A and *B* are partners in a firm sharing Profits and Losses in the ratio of 17 : 16. They admit *C* as a partner on 1st April, 2016 on the basis of his buying 5/17th of *A*'s share and 4/16th of *B*'s share. On 1st April, 2018 they permit *C* to purchase a further 1/12th of their remaining shares. Goodwill is agreed to be valued at 2 years' purchase of the average profits of 3 years immediately before any change. Profits for the 5 years ended 31st March, 2018 are:

Years Ended	31st March, 2014	31st March, 2015	31st March, 2016	31st March, 2017	31st March, 2018
Profits (₹)	15,390	16,130	20,415	23,535	28,780

You are required to determine the amount to be paid by *C* to each partner on both the occasions and their ultimate Profit-sharing Ratio.

Solution:

On 1st Occasion (1st April, 2016):

C buys 5/17th share of *A*, *i.e.*, 17/33 × 5/17 = 5/33 and 4/16th share of *B*, *i.e.*, 16/33 × 4/16 = 4/33.

$$\text{Goodwill} = \frac{₹\,15,390 + ₹\,16,130 + ₹\,20,415}{3} \times 2 = ₹\,34,623$$

C will pay ₹ 5,246 to *A* (*i.e.*, ₹ 34,623 × 5/33 for acquiring 5/33rd share) and ₹ 4,197 to *B* (*i.e.*, ₹ 34,623 × 4/33 for acquiring 4/33rd share).

New Profit-sharing Ratio: *A*(17/33 – 5/33 = 12/33); *B*(16/33 – 4/33 = 12/33); *C*(5/33 + 4/33 = 9/33) or 12/33: 12/33: 9/33 or 4 : 4 : 3.

On 2nd Occasion (1st April, 2018):

C purchases 1/12th of remaining shares of *A* and *B* which is 12/33 (each). Therefore, *C* purchases 12/33 × 1/12 = 1/33rd share (each). New Profit-sharing Ratio will be *A*(12/33 – 1/33 = 11/33); *B*(12/33 – 1/33 = 11/33); *C*(9/33 + 1/33 + 1/33 = 11/33) or 11/33 : 11/33 : 11/33 or 1 : 1 : 1.

Ultimate Profit-Sharing Ratio will be equal.

$$\text{Goodwill} = \frac{₹\,20,415 + ₹\,23,535 + ₹\,28,780}{3} \times 2 = ₹\,48,487.$$

On 2nd occasion, *C* will pay ₹ 1,469 each (*i.e.*, ₹ 48,487 × 1/33) to *A* and *B* (for acquiring 1/33rd share from each of them).

Illustration 2 (*Calculation of Investment to be made to become a Partner*).

A commenced his business with a capital of ₹ 5,00,000 on 1st April, 2013. During 5 years ended 31st March, 2018, the results of his business were:

Year Ended		₹
31st March, 2014	Loss	10,000
31st March, 2015	Profit	26,000
31st March, 2016	Profit	34,000
31st March, 2017	Profit	40,000
31st March, 2018	Profit	50,000

During this period, he withdrew ₹ 80,000 for his personal use. On 1st April, 2018, he admitted *B* into partnership on the following terms:

(*i*) Goodwill is to be valued at 3 times the average profits of the last 5 years.

(*ii*) *B* will have 1/2 share in future profits.

(*iii*) He will bring his share of goodwill in cash.

(*iv*) He will bring capital in cash equal to that of *A* after his admission.

Calculate amount to be brought in by *B* and pass entries to record the transactions pertaining to admission.

Solution:

(*i*) *Calculation of Share of Goodwill to be brought in by B:*

		₹
(*a*)	Total profits for 5 years (– ₹ 10,000 + ₹ 26,000 + ₹ 34,000 + ₹ 40,000 + ₹ 50,000)	1,40,000
(*b*)	Average profits (₹ 1,40,000/5)	28,000
(*c*)	Amount of Goodwill (₹ 28,000 × 3)	84,000
(*d*)	Share of Goodwill to be brought in by *B* (₹ 84,000/2)	**42,000**

(*ii*) *Calculation of A's Capital as on 31st March, 2018:*

(*a*)	Capital as on 1st April, 2013	5,00,000
(*b*)	*Add:* Net profit for 5 years	1,40,000
		6,40,000
(*c*)	*Less*: Drawings	80,000
		5,60,000

(*iii*) *Calculation of amount to be invested by B:*

A's Capital after *B*'s admission = ₹ 5,60,000 + Amount of goodwill to be brought in
= ₹ 5,60,000 + ₹ 42,000 = ₹ 6,02,000

Therefore, *B* will have to bring ₹ 6,02,000 as Capital and ₹ 42,000 as share of Goodwill.

Total amount to be brought in by *B* = ₹ 6,02,000 + ₹ 42,000 = ₹ **6,44,000**.

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
April 1	Cash A/c ...Dr.		6,44,000	
	To *B*'s Capital A/c			6,02,000
	To Premium for Goodwill A/c			42,000
	(Being the amount brought in by *B*)			
April 1	Premium for Goodwill A/c ...Dr.		42,000	
	To *A*'s Capital A/c			42,000
	(Being the amount of goodwill credited to *A*'s Capital Account)			

Illustration 3.

Akash, Biswas, and Pooja are partners sharing profits and losses equally. Their Balance Sheet as at 31st March, 2019 was as follows:

BALANCE SHEET *as at 31st March, 2019*

Liabilities			₹	Assets	₹
Sundry Creditors			30,000	Goodwill	40,000
General Reserve			10,000	Sundry Debtors	70,000
Workmen Compensation Reserve			10,000	Stock	60,000
Investment Fluctuation Reserve			40,000	Machinery	1,00,000
Capital A/cs:	Akash	2,00,000		Investment	1,60,000
	Biswas	90,000		Cash in Hand	10,000
	Pooja	60,000	3,50,000		
			4,40,000		4,40,000

They admit Deep into partnership with effect from 1st April, 2019. They would share profits and losses in 5 : 3 : 2 : 2. It was agreed that:

(*i*) Stock be valued at ₹ 90,000.
(*ii*) Machinery is reduced by 10%.
(*iii*) A liability of ₹ 5,000 included in sundry creditors is not likely to arise.
(*iv*) Market value of investment is ₹ 1,00,000.
(*v*) Partners agreed that the revised values are not to be recorded in the books.

You are required to pass Journal entry to give effect to the above.

Solution: *Calculation of Net Effect of Accumulated Profits, Losses and Reserves:*

		₹
General Reserve		10,000
Workmen Compensation Reserve		10,000
Investment Fluctuation Reserve		40,000
Add:	Increase in Value of Stock	30,000
	Decrease in Amount of Sundry Creditors	5,000
Less:	Decrease in Value of Machinery	(10,000)
	Goodwill	(40,000)
	Decrease in Value of Investment	(60,000)
Net Effect of Adjustment to be made		(15,000)

Calculation of Sacrifice/(Gain) of Each Partner:

	Akash	Biswas	Pooja	Deep
(*i*) Their Old Share	1/3	1/3	1/3	...
(*ii*) Their New Share	5/12	3/12	2/12	2/12
(*iii*) Sacrifice/(Gain) (*i* – *ii*)	–1/12	1/12	2/12	–2/12
	Gain	Sacrifice	Sacrifice	Gain

Akash's Gained Share = ₹ 15,000 × 1/12 = ₹ 1,250;
Biswas's Sacrificed Share = ₹ 15,000 × 1/12 = ₹ 1,250;
Pooja's Sacrificed Share = ₹ 15,000 × 2/12 = ₹ 2,500;
Deep's Gained Share = ₹ 15,000 × 2/12 = ₹ 2,500.

ADJUSTMENT JOURNAL ENTRY

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2019					
April 1	Biswas's Capital A/c	...Dr.		1,250	
	Pooja's Capital A/c	...Dr.		2,500	
	To Akash's Capital A/c				1,250
	To Deep's Current A/c				2,500
	(Being the adjustment entry passed)				

Illustration 4.

A, *B* and *C* are partners sharing profits and losses in the ratio of 3 : 2 : 1 respectively. *D* is admitted as a new partner on 31st March, 2019 for an equal share and is to pay ₹ 50,000 as Capital. Following is the Balance Sheet on the date of admission:

BALANCE SHEET

Liabilities	₹	Assets	₹
Capital A/cs:		Land and Building	50,000
A	60,000	Plant and Machinery	40,000
B	60,000	Furniture	30,000
C	40,000	Stock	20,000
Creditors	30,000	Debtors	30,000
Bills Payable	10,000	Bills Receivable	20,000
		Bank	10,000
	2,00,000		2,00,000

Following are the required adjustments on *D*'s admission:

(*i*) Out of the Creditors, a sum of ₹ 10,000 is due to *D* which will be transferred to his capital.

(*ii*) Advertisement Expenses of ₹ 1,200 is to be carried forward to next accounting period.

(*iii*) Expenses debited in the Profit and Loss Account includes a sum of ₹ 2,000 paid for *B*'s personal expenses.

(*iv*) A Bill of Exchange of ₹ 4,000, which was previously discounted with the banker, was dishonoured on 31st March, 2019 but no entry has been passed for that.

(*v*) Provision for Doubtful Debts @ 5% is to be created against Debtors.

(*vi*) Expenses on revaluation amounting to ₹ 2,100 is paid by *A*.

Prepare necessary Ledger Accounts and Balance Sheet after *D*'s admission.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Provision for Doubtful Debts A/c	1,700	By Prepaid Advertisement Expenses A/c		1,200
(5/100 × ₹ 34,000)		By *B*'s Capital A/c (*B*'s Drawings)		2,000
To *A*'s Capital A/c (Revaluation Expenses)	2,100	By Loss on Revaluation transferred to		
		Capital A/cs:		
		A (₹ 600 × 3/6)	300	
		B (₹ 600 × 2/6)	200	
		C (₹ 600 × 1/6)	100	600
	3,800			3,800

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* ₹	*B* ₹	*C* ₹	Particulars	*A* ₹	*B* ₹	*C* ₹
To Revaluation A/c (Loss)	300	200	100	By Balance *b/d*	60,000	60,000	40,000
To Revaluation A/c (Drawings)	...	2,000	...	By Revaluation A/c (Revaluation Expenses)	2,100	...	...
To Balance *c/d*	61,800	57,800	39,900				
	62,100	60,000	40,000		62,100	60,000	40,000

Dr. *D*'S CAPITAL ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *c/d*	50,000	By Bank A/c	40,000
		By Creditors A/c	10,000
	50,000		50,000

Dr. BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	10,000	By Debtors A/c (B/R Dishonoured)	4,000
To *D*'s Capital A/c	40,000	By Balance *c/d*	46,000
	50,000		50,000

BALANCE SHEET AFTER *D*'S ADMISSION
as at 31st March, 2019

Liabilities		₹	Assets		₹
Capital A/cs:			Land and Building		50,000
A	61,800		Plant and Machinery		40,000
B	57,800		Furniture		30,000
C	39,900		Stock		20,000
D	50,000	2,09,500	Debtors	30,000	
Creditors (₹ 30,000 – ₹ 10,000)		20,000	*Add:* B/R Dishonoured	4,000	
Bills Payable		10,000		34,000	
			Less: Provision for Doubtful Debts	1,700	32,300
			Bills Receivable		20,000
			Bank		46,000
			Prepaid Advertisement Expenses		1,200
		2,39,500			2,39,500

Illustration 5.

A and *B* are partners in a firm. The net profit of the firm is divided as follows: 1/2 to *A*, 1/3 to *B* and 1/6 carried to Reserve. They admit *C* as a partner for 1/5th share in the firm on 1st April, 2019 on which date, the Balance Sheet of the firm was as follows:

Liabilities		₹	Assets	₹
Capital A/cs:			Building	5,00,000
A	5,00,000		Plant and Machinery	3,00,000
B	4,00,000	9,00,000	Stock	1,80,000
Reserve		1,00,000	Debtors	2,20,000
Creditors		2,00,000	Bank	50,000
Outstanding Expenses		50,000		
		12,50,000		12,50,000

Following are the required adjustments on *C*'s admission:

(*i*) *C* brings in ₹ 2,00,000 as his Capital and ₹ 50,000 as his share of Goodwill.

(*ii*) Stock is undervalued by 10%.

(*iii*) Creditors include a liability of ₹ 40,000, which has been decided by the court at ₹ 32,000.

(*iv*) In regard to the Debtors, the following debts proved bad or doubtful:
₹ 20,000 due from *X*—bad to the full extent.
₹ 40,000 due from *Y*—insolvent, estate was expected to pay only 50%.

You are required to prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the new firm.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Bad Debts A/c (*X*)	20,000	By Stock A/c		20,000
To Provision for Doubtful Debts A/c (*Y*)	20,000	(₹ 2,00,000 (WN 1) – ₹ 1,80,000)		
(₹ 40,000 × 50/100)		By Creditors A/c		8,000
		(₹ 40,000 – ₹ 32,000)		
		By Loss on Revaluation transferred to:		
		A's Capital A/c	7,200	
		B's Capital A/c	4,800	12,000
	40,000			40,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* ₹	*B* ₹	*C* ₹	Particulars	*A* ₹	*B* ₹	*C* ₹
To Revaluation A/c (Loss)	7,200	4,800	...	By Balance *b/d*	5,00,000	4,00,000	...
To Balance *c/d*	5,82,800	4,55,200	2,00,000	By Reserve A/c	60,000	40,000	...
				By Bank A/c	...	...	2,00,000
				By Premium for Goodwill A/c	30,000	20,000	...
	5,90,000	4,60,000	2,00,000		5,90,000	4,60,000	2,00,000

BALANCE SHEET *as at 1st April, 2019*

Liabilities		₹	Assets		₹
Capital A/cs:			Building		5,00,000
A	5,82,800		Plant and Machinery		3,00,000
B	4,55,200		Stock		2,00,000
C	2,00,000	12,38,000	Debtors	2,20,000	
Creditors (₹ 2,00,000 – ₹ 8,000)		1,92,000	*Less:* Bad Debts (*X*)	20,000	
Outstanding Expenses		50,000		2,00,000	
			Less: Provision for Doubtful Debts (*Y*)	20,000	1,80,000
			Bank (₹ 50,000 + ₹ 50,000 + ₹ 2,00,000)		3,00,000
		14,80,000			14,80,000

Working Notes:

1. Original value of stock = ₹ 1,80,000 × 100/90 = ₹ 2,00,000.
2. Profit-sharing ratio between *A* and *B* = 1/2 : 1/3 = 3 : 2.

Illustration 6.

X and *Y* were trading in partnership sharing profits and losses in the ratio of 7 : 5. On 1st April, 2017, they admitted *Z* into partnership on the following terms:

Z was to have 1/6th share, 1/8th from *X* and 1/24th from *Y* paying ₹ 2,00,000 for that share towards premium for goodwill. *Z* also brought ₹ 2,50,000 as his Capital into the firm. It was further agreed that Machinery should be reduced by 10% and that Investments should be reduced to their market value of ₹ 80,000.

The Balance Sheet of the old firm as at 31st March, 2017 was as follows:

Liabilities		₹	Assets	₹
Creditors		1,60,000	Machinery	2,00,000
Capital A/cs:			Furniture	40,000
X	2,50,000		Investments (At Cost)	1,20,000
Y	2,50,000	5,00,000	Stock	1,00,000
			Debtors	60,000
			Cash at Bank	1,40,000
		6,60,000		6,60,000

Interest on Drawings is to be ignored but Interest on Capital is to be allowed at 5% p.a. The profits of the new firm for the year ended 31st March, 2018 amounted to ₹ 5,24,500 before allowing interest on capitals. Drawings of the partners during the year were: *X*—₹ 1,63,250; *Y*—₹ 1,38,750 and *Z*—₹ 32,500.

You are required to show Partners' Capital Accounts and prepare Balance Sheet as at 31st March, 2016.

Solution:

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Date	Particulars	*X* ₹	*Y* ₹	*Z* ₹	Date	Particulars	*X* ₹	*Y* ₹	*Z* ₹
2017					2017				
Apr. 1	To Revaluation A/c —Loss (WN 2)	35,000	25,000	...	Apr. 1	By Balance *b/d*	2,50,000	2,50,000	...
Apr. 1	To Balance *c/d* (WN 3)	3,65,000	2,75,000	2,50,000	Apr. 1	By Premium for Goodwill A/c (WN 1)	1,50,000	50,000	...
					Apr. 1	By Bank A/c	...	...	2,50,000
		4,00,000	3,00,000	2,50,000			4,00,000	3,00,000	2,50,000
2018					2017				
Mar. 31	To Drawings A/c	1,63,250	1,38,750	32,500	Apr. 1	By Balance *b/d*	3,65,000	2,75,000	2,50,000
Mar. 31	To Balance *c/d*	4,40,000	3,30,000	3,10,000	2018				
					Mar. 31	By Interest on Capital A/cs	18,250	13,750	12,500
					Mar. 31	By P and L App. A/c (Profit)	2,20,000	1,80,000	80,000
		6,03,250	4,68,750	3,42,500			6,03,250	4,68,750	3,42,500

BALANCE SHEET
as at 31st March, 2018

Liabilities		₹	Assets	₹
Capital A/cs: *X*	4,40,000		Machinery (₹ 2,00,000 – ₹ 20,000)	1,80,000
Y	3,30,000		Furniture	40,000
Z	3,10,000	10,80,000	Investments (₹ 1,20,000 – ₹ 40,000)	80,000
Creditors		1,60,000	Stock	1,00,000
			Debtors	60,000
			Cash at Bank (WN 5)	7,80,000
		12,40,000		12,40,000

Working Notes:

1. Goodwill should be distributed as per sacrificing ratio, *i.e.*, 1/8 : 1/24 or 3 : 1.

   X's share = ₹ 2,00,000 × 3/4 = ₹ **1,50,000**; *Y*'s share = ₹ 2,00,000 × 1/4 = ₹ **50,000**.

2. *Dr.* REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Machinery A/c	20,000	By Loss transferred to:		
To Investments A/c	40,000	*X*'s Capital A/c (7/12)	35,000	
		Y's Capital A/c (5/12)	25,000	**60,000**
	60,000			60,000

3. Since there is interest on capital, it is better to carry forward this balance of Capital Account and thereafter interest on capital should be allowed.

4. **New Profit-sharing Ratio**

   X's New Share = 7/12 – 1/8 = 11/24, *Y*'s New Share = 5/12 – 1/24 = 9/24.

   Hence New Profit-sharing Ratio of *X*, *Y* and *Z* = 11/24 : 9/24 : 1/6 = **11 : 9 : 4**.

PROFIT AND LOSS APPROPRIATION ACCOUNT
5. *Dr.* *for the year ended 31st March, 2018* *Cr.*

Particulars		₹	Particulars	₹
To Interest on Capital A/cs:			By Profit and Loss A/c	5,24,500
X	18,250		—Net Profit	
Y	13,750			
Z	12,500	44,500		
To Share of Profit trfd. to Capital A/cs:				
X (₹ 4,80,000 × 11/24)	2,20,000			
Y (₹ 4,80,000 × 9/24)	1,80,000			
Z (₹ 4,80,000 × 4/24)	80,000	**4,80,000**		
		5,24,500		5,24,500

6. *Dr.* BANK ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Balance *b/d*	1,40,000	By Drawings A/cs:		
To Premium for Goodwill A/c	2,00,000	*X*	1,63,250	
To *Z*'s Capital A/c	2,50,000	*Y*	1,38,750	
To Profit and Loss A/c (*i.e.*, Increase in Cash)	5,24,500	*Z*	32,500	3,34,500
		By Balance *c/d*		**7,80,000**
	11,14,500			11,14,500

Illustration 7.

X and *Y* are partners in a firm sharing profits and losses in the ratio of 3 : 2. They admit *Z* as a partner for 1/5th share. *Z* acquires his share from *X* and *Y* in the ratio of 2 : 3. Goodwill of the firm has been valued at ₹ 50,000. *Z* issued cheques from his account of ₹ 10,000 in favor of '*X*' and '*Y*' as his share of goodwill. What Journal entry in the books of the firm is to be passed?

Solution: No Journal entry will be passed in the books of the firm since *Z* has paid his share of goodwill to *X* and *Y* privately, outside the firm.

Illustration 8.

Pass Journal entry to distribute Workmen Compensation Reserve of ₹ 50,000 at the time of admission of *Z*, when there is no claim against it. The firm has two partners *X* and *Y*.

Solution: JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Workmen Compensation Reserve A/c ...Dr.		50,000	
	To *X*'s Capital A/c			25,000
	To *Y*'s Capital A/c			25,000
	(Being Workmen Compensation Reserve transferred to partners in their old profit-sharing ratio)			

Illustration 9.

Give Journal entry to distribute 'Workmen Compensation Reserve' of ₹ 80,000 at the time of admission of *Z*, when there is claim of ₹ 60,000 against it. The firm has two partners *X* and *Y*.

Solution: JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Workmen Compensation Reserve A/c ...Dr.		80,000	
	To Workmen Compensation Claim A/c			60,000
	To *X*'s Capital A/c			10,000
	To *Y*'s Capital A/c			10,000
	(Being the workmen compensation claim accepted and surplus WCR transferred to partners in their old profit-sharing ratio)			

Notes: After adjusting Workmen Compensation Claim against the Workmen Compensation Reserve, the balance amount of ₹ 20,000 (*i.e.*, ₹ 80,000 – ₹ 60,000) is distributed between *X* and *Y* in their old profit-sharing ratio.

Illustration 10.

Give Journal entry to distribute 'Investment Fluctuation Reserve' of ₹ 40,000 at the time of admission of *Z*, when investment (market value ₹ 1,90,000) appears in the Balance Sheet at ₹ 2,00,000. The firm has two partners *X* and *Y*.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Investment Fluctuation Reserve A/c ...Dr.		40,000	
	To Investment A/c			10,000
	To *X*'s Capital A/c			15,000
	To *Y*'s Capital A/c			15,000
	(Being the value of investment brought down to market value and surplus IFR transferred to old partners in their old profit-sharing ratio)			

Note: In the given case, the market value of investment is ₹ 1,90,000 and the book value is ₹ 2,00,000. So, the fall in the value of ₹ 10,000 will be met through Investment Fluctuation Reserve and balance of ₹ 30,000 will be distributed between the old partners in their old profit-sharing ratio, *i.e.*, equally.

Illustration 11.

Usha and Asha are partners in a firm sharing profits in the ratio of 3 : 2. Their Balance Sheet as at 31st March, 2019 was as follows:

Liabilities		₹	Assets		₹
Creditors		27,000	Cash		24,000
General Reserve		18,000	Debtors	48,000	
Bills Payable		5,000	*Less:* Provision for Doubtful Debts	4,800	43,200
Capital A/cs:			Stock		30,000
Usha	40,000		Patents		7,400
Asha	35,000	75,000	Building		20,400
		1,25,000			1,25,000

Neelam is admitted into the partnership giving her 1/5th share in the profits. Neelam is to bring in ₹ 30,000 as her Capital and her share of Goodwill in cash subject to the following terms:

(*i*) Goodwill of the firm to be valued at ₹ 50,000.

(*ii*) Stock to be reduced by 10% and Provision for Doubtful Debts be reduced by ₹ 2,400.

(*iii*) Patents are valueless.

(*iv*) There was a claim against the firm for damages amounted to ₹ 2,000. The claim has now been accepted.

(*v*) The partners have decided that General Reserve is to appear in the books of new firm at its original value.

Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the new firm.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Stock A/c	3,000	By Provision for Doubtful Debts A/c		2,400
To Patents A/c	7,400	By Loss on Revaluation transferred to:		
To Claim for Damages A/c	2,000	Usha's Capital A/c	6,000	
		Asha's Capital A/c	4,000	10,000
	12,400			12,400

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Usha ₹	Asha ₹	Neelam ₹	Particulars	Usha ₹	Asha ₹	Neelam ₹
To Revaluation A/c (Loss)	6,000	4,000	...	By Balance *b/d*	40,000	35,000	...
To Balance *c/d*	42,160	36,440	30,000	By Neelam's Current A/c	2,160	1,440	...
				By Cash A/c	...	...	30,000
				By Premium for Goodwill A/c	6,000	4,000	...
	48,160	40,440	30,000		48,160	40,440	30,000

BALANCE SHEET OF NEW FIRM *as at 31st March, 2019*

Liabilities		₹	Assets		₹
Creditors		27,000	Cash (₹ 24,000 + ₹ 40,000)		64,000
Claim for Damages		2,000	Debtors	48,000	
Bills Payable		5,000	*Less:* Provision for Doubtful Debts	2,400	45,600
General Reserve		18,000	Stock (₹ 30,000 – ₹ 3,000)		27,000
Capital A/cs:			Building		20,400
Usha	42,160		Neelam's Current A/c		3,600
Asha	36,440				
Neelam	30,000	1,08,600			
		1,60,600			1,60,600

Notes:

1. Neelam's Share of Goodwill = ₹ 50,000 × 1/5 = ₹ 10,000, credited to Usha and Asha in their sacrificing ratio, *i.e.*, 3 : 2.
2. *For Adjustment of General Reserve:*
   Dr. Neelam's Current A/c: ₹ 3,600 (*i.e.*, ₹ 18,000 × 1/5);
   Cr. Usha's Capital A/c: ₹ 2,160 (*i.e.*, ₹ 3,600 × 3/5); and Asha's Capital A/c: ₹ 1,440 (*i.e.*, ₹ 3,600 × 2/5).

Illustration 12.

Rose and Daisy carried on a business in partnership sharing profits and losses in the ratio of 3 : 1. Their Balance Sheet as at 31st March, 2019 was as under:

Liabilities		₹	Assets		₹
Capital A/cs:			Land and Building		62,500
Rose	75,000		Furniture		2,500
Daisy	40,000	1,15,000	Debtors	41,250	
General Reserve		10,000	*Less:* Provision for Doubtful Debts	1,250	40,000
Creditors		93,750	Bills Receivable		7,500
			Stock		50,000
			Cash at Bank		56,250
		2,18,750			2,18,750

Lily was admitted as a partner on 1st April, 2019 on the following terms:

(*i*) She was to bring in ₹ 35,000 as her Capital for 1/5th share in the profits.

(*ii*) Goodwill of the firm was valued at ₹ 1,00,000. Lily was to bring half of her share of Goodwill in cash.

(*iii*) Stock and Furniture were to be reduced in value by 10% and the Provision for Doubtful Debts was to be brought up to 10% of the Debtors.

(*iv*) The value of Land and Building was appreciated by 25%.

(*v*) Creditors include an amount of ₹ 5,000 received as commission from Pinky. The necessary adjustment is required to be made.

You are required to prepare necessary accounts and Balance Sheet of the newly constituted firm. (*ISC 1995, Modified*)

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Stock A/c		5,000	By Land and Building A/c (25% of ₹ 62,500)	15,625
To Furniture A/c		250	By Creditors A/c	5,000
To Provision for Doubtful Debts A/c (₹ 4,125 – ₹ 1,250)		2,875		
To Gain (Profit) on Revaluation:				
Rose (3/4)	9,375			
Daisy (1/4)	3,125	12,500		
		20,625		20,625

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Rose ₹	Daisy ₹	Lily ₹	Particulars	Rose ₹	Daisy ₹	Lily ₹
To Balance *c/d*	1,06,875	50,625	35,000	By Balance *b/d*	75,000	40,000	...
				By General Reserve A/c	7,500	2,500	...
				By Bank A/c	...	...	35,000
				By Premium for Goodwill A/c (WN 1)	7,500	2,500	...
				By Lily's Current A/c (WN 2)	7,500	2,500	...
				By Revaluation A/c (Gain)	9,375	3,125	...
	1,06,875	50,625	35,000		1,06,875	50,625	35,000

Dr. BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance b/d	56,250	By Balance *c/d*	1,01,250
To Lily's Capital A/c	35,000		
To Premium for Goodwill A/c	10,000		
	1,01,250		1,01,250

BALANCE SHEET *as at 1st April, 2019*

Liabilities		₹	Assets		₹
Capital A/cs:			Land and Building		78,125
Rose	1,06,875		Furniture		2,250
Daisy	50,625		Debtors	41,250	
Lily	35,000	1,92,500	*Less:* Provision for Doubtful Debts	4,125	37,125
Creditors		88,750	Stock		45,000
			Bills Receivable		7,500
			Cash at Bank		1,01,250
			Lily's Current A/c		10,000
		2,81,250			2,81,250

Working Notes:

1. Goodwill brought in part by Lily in cash (₹ 10,000) has been distributed between Rose and Daisy in their sacrificing ratio of 3 : 1.
2. Goodwill not brought in cash out of her share ₹10,000 (*i.e.*, ₹ 1,00,000 × 1/5 × 1/2). It has been adjusted through Lily's Current Account.

Illustration 13.

A and *B* are partners in a firm sharing profits in 2 : 1 ratio. They admitted *C* for 1/4th share in profits. *C* was to bring ₹ 30,000 as capital and capitals of *A* and *B* were to be adjusted in the profit-sharing ratio on the basis of *C*'s Capital. The Balance Sheet of *A* and *B* as at 31st March, 2018 (before *C*'s admission) was:

Liabilities		₹	Assets	₹
Sundry Creditors		20,000	Cash	2,000
Bills Payable		19,000	Sundry Debtors	50,000
General Reserve		6,000	Stock	10,000
Workmen Compensation Reserve		24,000	Machinery	25,000
Capital A/cs:			Building	40,000
A	50,000		Goodwill	15,000
B	32,000	82,000	Advertisement Expenditure	9,000
		1,51,000		1,51,000

Other terms of agreement were:

(*i*) *C* will bring ₹ 12,000 for his share of goodwill.

(*ii*) Building was valued at ₹ 45,000 and Machinery at ₹ 23,000.

(*iii*) A Provision of Doubtful Debts was created @ 6% on Sundry Debtors.

(*iv*) Capital Accounts of *A* and *B* were adjusted by opening Current Accounts.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of *A*, *B* and *C*.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Machinery A/c	2,000	By Building A/c	5,000
To Provision for Doubtful Debts A/c	3,000		
	5,000		5,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* ₹	*B* ₹	*C* ₹	Particulars	*A* ₹	*B* ₹	*C* ₹
To Goodwill A/c	10,000	5,000	...	By Balance *b/d*	50,000	32,000	...
To Advertisement Expenditure A/c	6,000	3,000	...	By General Reserve A/c	4,000	2,000	...
To *A*'s Current A/c (Bal. Fig.)	2,000	8,000	...	By Workmen Compensation Reserve A/c	16,000	8,000	...
To Balance *c/d*	60,000	30,000	30,000	By Bank A/c	...	...	30,000
				By Premium for Goodwill A/c	8,000	4,000	...
	78,000	46,000	30,000		78,000	46,000	30,000

BALANCE SHEET OF *A*, *B* AND *C as at 31st March, 2018*

Liabilities		₹	Assets		₹
Sundry Creditors		20,000	Cash (₹ 2,000 + ₹ 30,000 + ₹ 12,000)		44,000
Bills Payable		19,000	Sundry Debtors	50,000	
Current A/cs:			*Less:* Provision for Doubtful Debts	3,000	47,000
A	2,000		Stock		10,000
B	8,000	10,000	Machinery		23,000
Capital A/cs:			Building		45,000
A	60,000				
B	30,000				
C	30,000	1,20,000			
		1,69,000			1,69,000

Working Notes:

1. *Calculation of New Profit-Sharing Ratio:*
   C joins the firm for 1/4th share of profits. Therefore, 3/4 (*i.e.*,1 – 1/4) will be shared by *A* and *B* in the ratio of 2 : 1. Thus,
   A's share = 3/4 × 2/3 = 6/12; *B*'s share = 3/4 × 1/3 = 3/12;
   C's share of profit = 1/4,
   Therefore, New Profit-sharing Ratio of *A*, *B* and *C* = 6/12 : 3/12 : 1/4 or 6 : 3 : 3 or 2 : 1 : 1.
2. *Adjustment of Capital:*
   Total capital of the firm on the basis of *C*'s capital = ₹ 30,000 × 4/1 = ₹ 1,20,000
   A's Capital = ₹ 1,20,000 × 6/12 = ₹ 60,000
   B's Capital = ₹ 1,20,000 × 3/12 = ₹ 30,000
   C's Capital = ₹ 1,20,000 × 3/12 = ₹ 30,000.

Illustration 14.

Angad and Vivek are partners in a firm sharing profits and losses in the ratio of 3 : 2. Their Balance Sheet as at 1st January, 2005 stood as follows:

BALANCE SHEET *as at 1st January, 2005*

Liabilities		₹	Assets	₹
Creditors		15,000	Cash	2,000
General Reserve		10,000	Debtors	18,000
Capital A/cs:			Stock	20,000
Angad	30,000		Furniture	10,000
Vivek	25,000	55,000	Plant	30,000
		80,000		80,000

Gopal is admitted as a partner on the above date on the following terms:

(*i*) He will pay ₹ 10,000 towards Goodwill for 1/4th share in profits.

(*ii*) The assets are to be revalued as under:
Plant ₹ 32,000; Stock ₹ 18,000.

(*iii*) A Provision for Bad Debts at 5% on Debtors has to be created.

(*iv*) A sum of ₹ 1,400 included in Creditors is not to be paid. There is an unrecorded liability for ₹ 5,000 which is to be recorded in the books.

(*v*) Gopal is to bring in ₹ 20,000 as capital. The capitals of other partners are to be adjusted in new profit-sharing ratio. For this purpose Current Accounts are to be opened.

Prepare:

(*a*) the Capital Accounts of Angad, Vivek and Gopal.

(*b*) the Balance Sheet of the new firm. (*ISC 2007*)

Solution:

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Angad ₹	Vivek ₹	Gopal ₹	Particulars	Angad ₹	Vivek ₹	Gopal ₹
To Revaluation A/c (Loss) (WN 1)	2,700	1,800	...	By Balance *b/d*	30,000	25,000	...
To Angad's Current A/c (Bal. Fig.—Transfer)	3,300	...	...	By General Reserve A/c	6,000	4,000	...
To Vivek's Current A/c (Bal. Fig.— Transfer)	...	7,200	...	By Cash A/c	...	...	20,000
To Balance *c/d* (WN 3)	36,000	24,000	20,000	By Premium for Goodwill A/c	6,000	4,000	...
	42,000	33,000	20,000		42,000	33,000	20,000

BALANCE SHEET OF THE NEW FIRM *as at 1st January, 2005*

Liabilities		₹	Assets		₹
Creditors (₹ 15,000 – ₹ 1,400)		13,600	Debtors	18,000	
Unrecorded Liability		5,000	*Less:* Provision for Bad Debts	900	17,100
Current A/cs:			Stock (₹ 20,000 – ₹ 2,000)		18,000
Angad	3,300		Furniture		10,000
Vivek	7,200	10,500	Plant (₹ 30,000 + ₹ 2,000)		32,000
Capital A/cs:			Cash		32,000
Angad	36,000				
Vivek	24,000				
Gopal	20,000	80,000			
		1,09,100			1,09,100

Working Notes:

1. *Dr.* REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Stock A/c	2,000	By Plant A/c	2,000
To Provision for Bad Debts A/c	900	By Creditors A/c	1,400
To Unrecorded Liability A/c	5,000	By Loss on Revaluation transferred to:	
		Angad's Capital A/c (₹ 4,500 × 3/5)	2,700
		Vivek's Capital A/c (₹ 4,500 × 2/5)	1,800
	7,900		7,900

2. *Calculation of New Profit-sharing Ratio:*

Gopal is coming for 1/4th share. The remaining $1-\frac{1}{4}\text{th}=\frac{3}{4}\text{th}$ share will be divided between Angad and Vivek in the ratio of 3 : 2. Therefore, the new profit-sharing ratio will be:

Angad's Share of Profit = 3/5 of 3/4 = 9/20.

Vivek's Share of Profit = 2/5 of 3/4 = 6/20.

Gopal's Share of Profit = 1/4 = 5/20.

New Profit-sharing Ratio = 9/20 : 6/20 : 5/20 or 9 : 6 : 5.

3. *Calculation of Proportionate Capital of Angad and Vivek on the basis of New Profit-sharing Ratio:*

(*i*) Total Capital of the New Firm = $\dfrac{\text{Capital of the New Partner (Gopal)}}{\text{Share of Profit of the New Partner (Gopal)}}$

$$= \frac{₹\ 20{,}000}{1/4} = ₹\ 20{,}000 \times 4/1 = ₹\ 80{,}000.$$

(*ii*) Angad's Capital = ₹ 80,000 × 9/20 = ₹ 36,000

Vivek's Capital = ₹ 80,000 × 6/20 = ₹ 24,000.

Illustration 15.

Following is the Balance Sheet as at 31st March, 2018 of *A* and *B*, who share profits and losses in the ratio of 3 : 2:

Liabilities		₹	Assets		₹
Capital A/cs:			Plant and Machinery		10,000
A	10,000		Land and Building		8,000
B	10,000	20,000	Debtors	12,000	
General Reserve		15,000	*Less:* Provision for Doubtful Debts	1,000	11,000
Workmen's Compensation Reserve		10,000	Stock		12,000
Creditors		10,000	Cash		9,000
			Profit and Loss A/c		5,000
		55,000			55,000

On 1st April, 2018, they agreed to admit *C* for 1/5th share of profits into partnership on the following terms:

(*i*) Provision for Doubtful Debts would be increased by ₹ 2,000.

(*ii*) Value of Land and Building would be increased to ₹ 18,000.

(*iii*) Value of Stock would be increased by ₹ 4,000.

(*iv*) The liability against the Workmen's Compensation Reserve is determined at ₹ 2,000.

(*v*) *C* brought in as his share of goodwill ₹ 10,000 in cash.

(*vi*) *C* would bring in further cash as would make his capital equal to 20% of the total capital of the new firm after the above revaluation and adjustments are carried out.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the firm after *C*'s admission.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c		2,000	By Land and Building A/c	10,000
To Gain (Profit) transferred to:			By Stock A/c	4,000
A's Capital A/c	7,200			
B's Capital A/c	4,800	12,000		
		14,000		14,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* ₹	*B* ₹	*C* ₹	Particulars	*A* ₹	*B* ₹	*C* ₹
To Profit and Loss A/c	3,000	2,000	...	By Balance *b/d*	10,000	10,000	...
To Balance *c/d* (Balancing Figure)	34,000	26,000	15,000	By Premium for Goodwill A/c	6,000	4,000	...
				By Revaluation A/c	7,200	4,800	...
				By General Reserve A/c	9,000	6,000	...
				By Workmen's Compensation Reserve A/c	4,800	3,200	...
				By Cash A/c (WN)	...	...	15,000
	37,000	28,000	15,000		37,000	28,000	15,000

BALANCE SHEET OF M/s *A*, *B* AND *C*
as at 1st April, 2018

Liabilities		₹	Assets		₹
Capital A/cs:			Land and Building		18,000
A	34,000		Plant and Machinery		10,000
B	26,000		Debtors	12,000	
C	15,000	75,000	*Less:* Provision for Doubtful Debts	3,000	9,000
Liability for Workmen's Compensation		2,000	Stock		16,000
Creditors		10,000	Cash [₹ 9,000 + ₹ 25,000 (WN)]		34,000
		87,000			87,000

Working Note:

Computation of C's Capital:	₹
Capital of *A* after all adjustments	34,000
Capital of *B* after all adjustments	26,000
Combined capital of *A* and *B* for 4/5th share	60,000

∴ Total capital of new firm = ₹ 60,000 × 5/4

C's share in capital = ₹ 60,000 × 5/4 × 1/5 = ₹ 15,000.

Total cash paid by C = Capital (₹ 15,000) + Share of goodwill (₹ 10,000)
= ₹ 25,000.

Illustration 16.

Amit and Sumit are partners sharing profits and losses in the ratio of 3 : 2. Their Balance Sheet as at 31st March, 2018 is given below:

Liabilities		₹	Assets		₹
Capital A/cs:			Land and Building		3,20,000
Amit	1,76,000		Investments (Market Value ₹ 55,000)		50,000
Sumit	2,54,000	4,30,000	Debtors	3,00,000	
Loan from Puneet		3,00,000	*Less:* Provision for Doubtful Debts	10,000	2,90,000
General Reserve		30,000	Stock		1,10,000
Employees' Provident Fund		10,000	Cash at Bank		50,000
Creditors		50,000			
		8,20,000			8,20,000

They decided to admit Puneet as a new partner from 1st April, 2018 on the following terms:

(*i*) Amit will give 1/3rd of his share and Sumit will give 1/4th of his share to Puneet.

(*ii*) Puneet's Loan Account will be converted into his Capital.

(*iii*) The Goodwill of the firm is valued at ₹ 3,00,000. Puneet will bring his share of Goodwill in cash and the same was immediately withdrawn by the partners.

(*iv*) Based on the valuation of an Architect, Land and Building was found undervalued by ₹ 1,00,000. Architect was paid ₹ 10,000 as his fee for Valuation Report.

(*v*) Stock was found overvalued by ₹ 50,000.

(*vi*) Provision for Doubtful Debts will be made equal to 5% of Debtors.

(*vii*) Investments are to be valued at their market price.

It was decided that the total capital of the firm after admission of new partner would be ₹ 10,00,000. Capital Accounts of Partners will be readjusted on the basis of their profit-sharing ratio and excess or deficiency will be adjusted in cash.

Prepare (*i*) Revaluation Account; (*ii*) Partners' Capital Accounts; and (*iii*) Balance Sheet of the firm after admission of new partner.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Stock A/c		50,000	By Land and Building A/c	1,00,000
To Provision for Doubtful Debts A/c		5,000	By Investments A/c	5,000
To Bank A/c (Architect's Fee)		10,000		
To Gain (Profit) on Revaluation t/f to:				
Amit's Capital A/c	24,000			
Sumit's Capital A/c	16,000	40,000		
		1,05,000		1,05,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Amit (₹)	Sumit (₹)	Puneet (₹)	Particulars	Amit (₹)	Sumit (₹)	Puneet (₹)
To Bank A/c	60,000	30,000	...	By Balance *b/d*	1,76,000	2,54,000	...
To Balance *c/d* (WN 3)	4,00,000	3,00,000	3,00,000	By General Reserve A/c	18,000	12,000	...
				By Revaluation A/c (Gain)	24,000	16,000	...
				By Puneet's Loan A/c	...	...	3,00,000
				By Premium for Goodwill (WN 2)	60,000	30,000	...
				By Bank A/c (Balancing Figure)	1,82,000	18,000	...
	4,60,000	3,30,000	3,00,000		4,60,000	3,30,000	3,00,000

BALANCE SHEET OF THE NEW FIRM *as at 1st April, 2018*

Liabilities		₹	Assets		₹
Creditors		50,000	Land and Building		4,20,000
Employees' Provident Fund		10,000	Investments		55,000
Capital A/cs:			Debtors	3,00,000	
Amit	4,00,000		*Less:* Provision for Doubtful Debts	15,000	2,85,000
Sumit	3,00,000		Stock		60,000
Puneet	3,00,000	10,00,000	Cash at Bank (WN 4)		2,40,000
		10,60,000			10,60,000

Working Notes:

1. *Calculation of Sacrificing Ratio and New Ratio:*

	Amit	Sumit
(*a*) Old Share	3/5	2/5
(*b*) Sacrifice	1/5(*i.e.*, 1/3 × 3/5)	1/10(*i.e.*, 1/4 × 2/5)
(*c*) New Share (*a* – *b*)	2/5 or 4/10	3/10

∴ Sacrificing Ratio of Amit and Sumit = 1/5 : 1/10 = 2 : 1

Puneet's Share = Sacrifice Share of Amit + Sacrifice Share of Sumit
= 1/5 + 1/10 = 3/10

Thus, New Profit-sharing Ratio of Amit, Sumit and Puneet = 4/10 : 3/10 : 3/10 = 4 : 3 : 3.

2. Puneet's Share of Goodwill = ₹ 3,00,000 × 3/10 = ₹ 90,000, which is contributed by Amit and Sumit in his sacrificing ratio, *i.e.*, 2 : 1.

3. *Capital of the Partners in New Firm:*

Total Capital of the New Firm = ₹ 10,00,000

Thus, Amit's Capital = 4/10 × ₹ 10,00,000 = ₹ 4,00,000;
Sumit's Capital = 3/10 × ₹ 10,00,000 = ₹ 3,00,000;
Puneet's Capital = 3/10 × ₹ 10,00,000 = ₹ 3,00,000.

4. *Dr.* BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	50,000	By Revaluation A/c (Architect's Fee)	10,000
To Premium for Goodwill A/c	90,000	By Amit's Capital A/c	60,000
To Amit's Capital A/c	1,82,000	By Sumit's Capital A/c	30,000
To Sumit's Capital A/c	18,000	By Balance *c/d*	2,40,000
	3,40,000		3,40,000

Illustration 17.

X and *Y* are partners sharing profits and losses in the ratio of 3 : 2. They admit *Z* as a new partner from 1st April, 2018. They have decided to share future profits in the ratio of 4 : 3 : 3. The Balance Sheet as at 31st March, 2018 is given below:

Liabilities	₹	Assets		₹
X's Capital	4,40,000	Goodwill		85,000
Y's Capital	6,35,000	Land and Building		1,50,000
Workmen Compensation Reserve	50,000	Investment (Market value ₹ 1,12,500)		1,25,000
Investment Fluctuation Reserve	25,000	Debtors	2,50,000	
Employees' Provident Fund	85,000	*Less:* Provision for Doubtful Debts	25,000	2,25,000
Z's Loan	7,50,000	Stock		7,50,000
		Bank Balance		6,25,000
		Advertisement Suspense A/c		25,000
	19,85,000			19,85,000

Terms of *Z*'s admission are as follows:

(*i*) *Z* contributes proportionate capital and 60% of his share of goodwill by cheque.

(*ii*) Goodwill is to be valued at 2 years' purchase of super profit of last three completed years. Profits for the years ended 31st March, were:

2016—₹ 12,00,000; 2017—₹ 23,25,000; 2018—₹ 34,50,000.

The normal profit is ₹ 13,25,000 with same amount of capital invested in similar industry.

(*iii*) Land and Building was found undervalued by ₹ 2,50,000.

(*iv*) Stock was found overvalued by ₹ 77,500.

(*v*) Provision for Doubtful Debts is to be made equal to 5% of the debtors.

(*vi*) Claim on account of Workmen Compensation is ₹ 25,000.

(*vii*) Workmen Compensation Reserve and Investment Fluctuation Reserve are to appear in the books of the new firm after adjusting Workmen Compensation Claim and difference between the book value and market value of investment. This adjustment is to be made through Partners' Current Accounts.

Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the new firm.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars		₹
To Stock A/c		77,500	By Land and Building A/c		2,50,000
To Gain (Profit) on Revaluation			By Provision for Doubtful Debts A/c:		
transferred to:			Existing	25,000	
X's Capital A/c	1,11,000		*Less:* Required (₹ 2,50,000 × 5/100)	12,500	12,500
Y's Capital A/c	74,000	1,85,000			
		2,62,500			2,62,500

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*X* ₹	*Y* ₹	*Z* ₹	Particulars	*X* ₹	*Y* ₹	*Z* ₹
To Goodwill A/c	51,000	34,000	...	By Balance *b/d*	4,40,000	6,35,000	...
To Advertisement				By Bank A/c (WN 5)	...	...	7,50,000
Suspense A/c	15,000	10,000	...	By Premium for Goodwill A/c	2,40,000	1,20,000	...
To Balance *c/d*	8,85,000	8,65,000	7,50,000	By *Z*'s Current A/c (WN 3)	1,60,000	80,000	...
				By Revaluation A/c (Profit)	1,11,000	74,000	...
	9,51,000	9,09,000	7,50,000		9,51,000	9,09,000	7,50,000

Dr. PARTNERS' CURRENT ACCOUNTS *Cr.*

Particulars	*X* ₹	*Y* ₹	*Z* ₹	Particulars	*X* ₹	*Y* ₹	*Z* ₹
To *X*'s Capital A/c (WN 3)	...	...	1,60,000	By *Z*'s Current A/c (WN 4)	7,500	3,750	...
To *Y*'s Capital A/c (WN 3)	...	...	80,000	By Balance *c/d*	...	...	2,51,250
To *X*'s Current A/c (WN 4)	...	...	7,500				
To *Y*'s Current A/c (WN 4)	...	...	3,750				
To Balance *c/d*	7,500	3,750	...				
	7,500	3,750	2,51,250		7,500	3,750	2,51,250

BALANCE SHEET OF THE NEW FIRM
as at 1st April, 2018

Liabilities		₹	Assets		₹
Employees' Provident Fund		85,000	Land and Building		4,00,000
Workmen Compensation Claim		25,000	Investment		1,12,500
Workmen Compensation Reserve (₹ 50,000 – ₹ 25,000)		25,000	Debtors	2,50,000	
			Less: Provision for Doubtful Debts	12,500	2,37,500
Investment Fluctuation Reserve		12,500	Stock		6,72,500
Z's Loan		7,50,000	Bank Balance		17,35,000
Current Accounts:			*Z*'s Current Account		2,51,250
X	7,500				
Y	3,750	11,250			
Capital Accounts:					
X	8,85,000				
Y	8,65,000				
Z	7,50,000	25,00,000			
		34,08,750			34,08,750

Working Notes:

1. *Calculation of Sacrificing Ratio:*

	X	*Y*
(*a*) Their Old Share	3/5	2/5
(*b*) Their New Share	4/10	3/10
(*c*) Share surrendered by old partner (*a* – *b*)	3/5 – 4/10 = 2/10	2/5 – 3/10 = 1/10

(*d*) Sacrificing Ratio of *X* and *Y* = 2/10 : 1/10 = 2 : 1.

2. *Calculation of Z's Share of Goodwill:*

(*a*) Average Profit = $\dfrac{₹\ 4{,}80{,}000 + ₹\ 9{,}30{,}000 + ₹\ 13{,}80{,}000}{3}$ = ₹ 23,25,000

(*b*) Normal Profit = ₹ 13,25,000

(*c*) Super Profit = ₹ 23,25,000 – ₹ 13,25,000 = ₹ 10,00,000

(*d*) Firm's Goodwill = Super Profit × No. of years' purchase = ₹ 10,00,000 × 2 = ₹ 20,00,000

(*e*) *Z*'s Share of Goodwill = ₹ 20,00,000 × 3/10 = ₹ 6,00,000.

3. *Journal Entries with respect to Goodwill:*

		₹	₹
(*i*) Bank A/c	...Dr.	3,60,000	
To Premium for Goodwill A/c			3,60,000
(*ii*) Premium for Goodwill A/c	...Dr.	3,60,000	
To *X*'s Capital A/c			2,40,000
To *Y*'s Capital A/c			1,20,000
(*iii*) *Z*'s Current A/c (₹ 6,00,000 – ₹ 3,60,000)	...Dr.	2,40,000	
To *X*'s Capital A/c			1,60,000
To *Y*'s Capital A/c			80,000

4. *For Adjustment of Workmen Compensation Reserve and Investment Fluctuation Reserve:*

	₹
Workmen Compensation Reserve = ₹ 50,000 – ₹ 25,000 (Claim)	25,000
Investment Fluctuation Reserve = ₹ 25,000 – (₹ 1,25,000 – ₹ 1,12,500)	12,500
	37,500

Adjustment Journal Entry with respect to Workmen Compensation Reserve and Investment Fluctuation Reserve:

	₹	₹
Z's Current A/c (₹ 37,500 × 3/10)	11,250	
To *X*'s Current A/c (₹ 37,500 × 2/10)		7,500
To *Y*'s Current A/c (₹ 37,500 × 1/10)		3,750

5. *Calculation of Z's Capital:*

	₹
X's Adjusted Capital	8,85,000
Y's Adjusted Capital	8,65,000
X's and *Y*'s Capital for 7/10th share	17,50,000

Thus, *Z*'s Capital for 3/10th share = ₹ 17,50,000 × 10/7 × 3/10 = ₹ 7,50,000.

6. *Dr.* BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	6,25,000	By Balance *c/d*	17,35,000
To Premium for Goodwill A/c	3,60,000		
To *Z*'s Capital A/c	7,50,000		
	17,35,000		17,35,000

Master Question

Illustration 18.

Rohan, Sohan and Mohan are partners sharing Profits and Losses in the ratio of 5 : 4 : 1. Their Balance Sheet as at 31st March, 2020 was as follows:

Liabilities		₹	Assets		₹
Sundry Creditors		2,50,000	Cash at Bank		4,20,000
Salaries Payable		60,000	Sundry Debtors	2,00,000	
Outstanding Expenses		20,000	*Less:* Provision for Doubtful Debts	20,000	1,80,000
General Reserve		1,80,000	Stock		1,00,000
Workmen Compensation Reserve		2,00,000	Furniture		1,80,000
Investment Fluctuation Reserve		2,20,000	Computers		4,00,000
Capital A/cs:			Investments		4,00,000
Rohan	6,00,000		Advertisement Expenditure		50,000
Sohan	3,00,000		Building		4,00,000
Mohan	3,00,000	12,00,000			
		21,30,000			21,30,000

Profit-sharing ratio *w.e.f.* 1st April, 2020 was decided to be equal. It was agreed among the partners to carry out following adjustments:

(i) Stock to be reduced to ₹ 80,000.

(ii) All debtors are good.

(iii) Computers to be reduced by ₹ 40,000.

(iv) Out of the salaries payable ₹ 20,000 was not payable as the employee left without notice.

(v) Outstanding Expenses were not payable.

(vi) An unrecorded asset (Motor Cycle) valued at ₹ 20,000 to be accounted.

(vii) The average profit earned by a firm is ₹ 2,50,000 which includes overvaluation of stock of ₹ 15,000 on an average basis. The capital invested in the business is ₹ 14,00,000 and the normal rate of return is 15%. Goodwill of the firm is valued on the basis of 2 times the super profit.

(viii) Workmen Compensation claim is estimated at ₹ 1,00,000.

(ix) Total Capital of the firm will be same as before the change in profit-sharing ratio and will be in new profit-sharing ratio of the partners, excess capital to be withdrawn and shortfall to be made good.

Prepare Revaluation Account, Partner's Capital Accounts and Balance Sheet of the new firm.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Stock A/c		20,000	By Provision for Doubtful Debts A/c	20,000
To Computers A/c		40,000	By Salaries Payable A/c	20,000
To Gain (Profit) transferred to:			By Outstanding Expenses A/c	20,000
Rohan	10,000		By Motor Cycle	20,000
Sohan	8,000			
Mohan	2,000	20,000		
		80,000		80,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Rohan ₹	Sohan ₹	Mohan ₹	Particulars	Rohan ₹	Sohan ₹	Mohan ₹
To Advertisement Exp. A/c	25,000	20,000	5,000	By Balance *b/d*	6,00,000	3,00,000	3,00,000
To Rohan's Capital A/c	...	...	8,334	By Revaluation	10,000	8,000	2,000
To Sohan's Capital A/c	...	...	3,333	By General Reserve	90,000	72,000	18,000
To Bank A/c (Bal. Fig.)	4,43,334	91,333	...	By Workman Compensation Reserve	50,000	40,000	10,000
To Balance *c/d*	4,00,000	4,00,000	4,00,000	By Investment Fluctuation Reserve	1,10,000	88,000	22,000
				By Mohan's Capital A/c	8,334	3,333	...
				By Bank	...	...	64,667
	8,68,334	5,11,333	4,16,667		8,68,334	5,11,333	4,16,667

BALANCE SHEET

as at 1st April, 2020

Liabilities		₹	Assets	₹
Bank Overdraft		50,000	Sundry Debtors	2,00,000
Salaries Payable		40,000	Stock	80,000
Creditors		2,50,000	Furniture	1,80,000
Workmen Compensation Claim		1,00,000	Computers	3,60,000
Capital A/cs:			Car	4,00,000
Rohan	4,00,000		Motor Cycle	20,000
Sohan	4,00,000		Building	4,00,00
Mohan	4,00,000	12,00,000		
		16,40,000		16,40,000

Working Notes:

1. *Calculation of Goodwill of Firm:*

Average Profit = ₹ 2,50,000

Overvaluation of Stock = ₹ 1,5000

Adjusted Average Profit = ₹ 2,50,000 – ₹ 15,000 (Note) = ₹ 2,35,000

Normal Profit = Capital Employed (Investment) × NRR

= ₹ 14,00,000 × 15/100 = ₹ 2,10,000

Super Profit = Adjusted Average Profit – Normal Profit

= ₹ 2,35,000 – ₹ 2,10,000 = ₹ 25,000

Goodwill = Super Profit × 2

= ₹ 25,000 × 2 = ₹ 50,000.

2. *Calculation of Sacrifice/Gain of each Partner:*

Particulars	Rohan	Sohan	Mohan
A. Old Share	5/10	4/10	1/10
B. New Share	1/3	1/3	1/3
C. Sacrifice/Gain (A – B)	5/10 – 1/3	4/10 – 1/3	1/10 – 1/3
	= 5/30 (Sacrifice)	2/30 (Sacrifice)	7/30 (Gain)

Note: Overvaluation of stock increases the net profit. Hence it has been deducted to calculate adjusted average profit.

3. *Adjustment of Goodwill:*

Mohan's Capital A/c	...Dr.	₹ 11,667	
To Rohan's Capital A/c			₹ 8333
To Sohan's Capital A/c			₹ 3,334

4. Total Capital of the Firm = ₹ 12,00,000
Capital of each partner in the new firm as per new profit-sharing ratio will be ₹ 4,00,000.

5.

Dr. BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	4,20,000	By Rohan's Capital A/c	4,43,334
To Mohan's Capital A/c	64,667	By Sohan's Capital A/c	91,333
To Balance *c/d*	50,000		
	5,34,667		5,34,667

Unsolved Questions

1. *A* and *B* are partners in a firm sharing Profits and Losses in the ratio of 17 : 16. They admit *C* as a partner on 1st April, 2016 on the basis of his buying 5/17th of *A*'s share and 4/16th of *B*'s share. On 1st April, 2018 they permit *C* to purchase further 1/12th of their remaining shares. Goodwill is agreed to be valued at 2 years' purchase of the average profits of 3 years immediately before any change. Profits for the 5 years ended 31st March, 2018 are:

Years Ended	31st March, 2014	31st March, 2015	31st March, 2016	31st March, 2017	31st March, 2018
Profits (₹)	61,560	64,520	81,660	94,140	1,15,120

You are required to determine the amount to be paid by *C* to each partner on both the occasions and their ultimate Profit-sharing Ratio.

2. *A* and *B* are partners sharing profits in the ratio of 3 : 2. They admit *C* into the firm for 3/7th share in profits which he takes 2/7th from *A* and 1/7th from *B* and brings ₹ 10,000 as premium out of his share of ₹ 16,000. Pass Journal entries for the above.

3. On the admission of Rao, it was agreed that the goodwill of Murty and Shah should be valued at ₹ 30,000. Rao is to get 1/4th share of profits. Previously Murty and Shah shared profits in the ratio of 3 : 2. Rao cannot bring his share of Goodwill. Give Journal entries in the books of Murty and Shah when: (i) there is no Goodwill Account; (ii) Goodwill appears at ₹ 10,000.

4. Following is the Balance Sheet of the firm, Ashirvad, owned by *A*, *B* and *C* who share profits and losses of the business in the ratio of 3 : 2 : 1:

BALANCE SHEET
as at 31st March, 2018

Liabilities		₹	Assets	₹
Capital A/cs:			Furniture	95,000
A	1,20,000		Business Premises	2,05,000
B	1,20,000		Stock-in-Trade	40,000
C	1,20,000	3,60,000	Debtors	28,000
Sundry Creditors		20,000	Cash at Bank	15,000
Outstanding Salaries and Wages		7,200	Cash in Hand	4,200
		3,87,200		3,87,200

On 1st April, 2018, they admit *D* as a partner on the following conditions:

(i) *D* will bring ₹ 1,20,000 as his Capital and also ₹ 30,000 as Goodwill premium for a quarter of the share in the future profit/loss of the firm.

(ii) The values of the fixed assets of the firm will be increased by 10% before the admission of *D*.

(iii) The future profits and losses of the firm will be shared equally by all the partners.

Show Journal entries, Revaluation Account, Partners' Capital Accounts and the opening Balance Sheet of the new firm to include the above-mentioned transactions assuming that the conditions were duly satisfied.

5. Jain and Gupta were partners in a firm sharing profits and losses in the ratio of 4 : 3. Following is the Balance Sheet of the firm as at 31st March, 2018:

BALANCE SHEET OF JAIN AND GUPTA *as at 31st March, 2018*

Liabilities		₹	Assets		₹
Sundry Creditors		20,000	Cash		14,800
Bills Payable		3,000	Debtors	20,500	
Bank Overdraft		17,000	*Less:* Provision for Doubtful Debts	300	20,200
Capital A/cs:			Stock		20,000
Jain	70,000		Plant		40,000
Gupta	60,000	1,30,000	Building		75,000
		1,70,000			1,70,000

They agreed to admit Mishra as partner with effect from 1st April, 2018 with 1/4th share in profits on the following terms:

(i) Mishra will bring in Capital to the extent of 1/4th of the total capital of the new firm after all adjustments have been made.

(ii) Building is to be appreciated by ₹ 14,000 and Plant to be depreciated by ₹ 7,000.

(iii) The Provision for Doubtful Debts on Debtors is to be raised to ₹ 1,000.

(iv) Mishra will bring ₹ 21,000 as his share of Goodwill.

Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the firm immediately after Mishra's admission.

6. *A* and *B* are partners in a firm sharing profits in the ratio of 5 : 3. Their Balance Sheet as at 31st March, 2018 is given below:

Liabilities		₹	Assets	₹
Capital A/cs:			Goodwill	10,000
A	55,000		Land and Building	25,000
B	30,000	85,000	Pant and Machinery	35,000
Creditors		19,000	Stock	20,000
Bills Payable		8,000	Debtors	25,000
General Reserve		16,000	Investments	14,000
Provision for Doubtful Debts		1,500	Cash	2,400
Outstanding Salary		2,400	Prepaid Insurance	500
		1,31,900		1,31,900

They agreed to admit *C* on 1st April, 2018 for 1/5th share of profit in future on the following terms:

(i) *C* brings in ₹ 5,200 as his share of Goodwill in cash and will bring in such an amount that his Capital will be 1/5th of the total capital of the new firm.

(ii) Land and Building and Plant and Machinery were to be valued at ₹ 38,000 and ₹ 30,000 respectively.

(iii) The Provision for Doubtful Debts was to be maintained up to ₹ 1,000.

(iv) A Liability for ₹ 1,200 included in Sundry Creditors was not likely to arise.

(v) Investments of ₹ 10,000 were taken over by old partners in their profit-sharing ratio.

(vi) *B* is to withdraw ₹ 2,400 in cash.

(vii) An amount of ₹ 100 is outstanding for repairs.

Prepare Revaluation Account, Partners' Capital Accounts, and Balance Sheet of the new firm.

7. Hari and Ram were in partnership, sharing profits and losses equally. On 1st April, 2019, Suraj was admitted into partnership on the following terms:

Suraj is to have 1/6th share in the profits/losses, which he had got from Hari paying him ₹ 40,000 for that share as goodwill. Out of this amount, Hari is to withdraw ₹ 30,000 and the balance amount is to remain in the firm. It was further agreed that the value of Investments should be reduced to ₹ 18,000 and Plant to be valued at ₹ 29,000. Creditors were to be reduced by ₹ 3,000 as one of the creditors has closed his business and gone. Suraj is to bring in proportionate capital on his admission. The Balance Sheet as at 31st March, 2019 was:

Liabilities		₹	Assets	₹
Creditors		1,05,000	Cash at Bank	40,000
Capital A/cs:			Book Debts	60,000
Hari	60,000		Stock	50,000
Ram	60,000	1,20,000	Investments	30,000
			Furniture	10,000
			Plant	35,000
		2,25,000		2,25,000

The profit for the year ended 31st March, 2020 was ₹ 60,000 and the drawings were:

Hari ₹ 15,000; Ram ₹ 22,500 and Suraj ₹ 7,500. Journalise the entries on Suraj's admission and give the Capital Accounts and the Balance Sheet as at 31st March, 2020.

GUIDE TO ANSWERS

1. *On Ist Occassion (1st April, 2016):*

Amount to be paid by *C*—₹ 20,984 to *A* and ₹ 16,787 to *B*. New Profit-sharing Ratio—4 : 4 : 3.

On 2nd Occassion (1st April, 2018):

Amount to be paid by *C*—₹ 5,877 to *A* and *B* each; New Profit-sharing Ratio—1 : 1 : 1.

Valuation of Goodwill:

$$\text{Average Profit} = \frac{₹\,61,560 + ₹\,64,520 + ₹\,81,660}{3} = ₹\,69,247$$

Goodwill at 2 Years' Purchase of Average Profit = ₹ 69,247 × 2 = ₹ 1,38,494.

$$C\text{'s Share in Goodwill} = ₹\,1,38,494 \times \frac{3}{11} = ₹\,37,771.$$

2. (i) Dr. Bank A/c and Cr. Premium for Goodwill A/c by ₹ 10,000.

(ii) Dr. Premium for Goodwill A/c—₹ 10,000; Cr. *A*'s Capital A/c—₹ 6,667 and *B*'s Capital A/c—₹ 3,333.

(iii) Dr. *C*'s Current A/c—₹ 6,000; Cr. *A*'s Capital A/c—₹ 4,000 and *B*'s Capital A/c—₹ 2,000.

3. (i) Dr. Rao's Current A/c—₹ 7,500; Cr. Murty's Capital A/c—₹ 4,500 and Shah's Capital A/c—₹ 3,000.

(ii) (a) Dr. Murty's Capital A/c—₹ 6,000 and Shah's Capital A/c—₹ 4,000; Cr. Goodwill A/c—₹ 10,000.

(b) Dr. Rao's Current A/c—₹ 7,500; Cr. Murty's Capital A/c—₹ 4,500 and Shah's Capital A/c—₹ 3,000.

4. Gain (Profit) on Revaluation—₹ 30,000; Capital Balances: *A*—₹ 1,65,000; *B*—₹ 1,40,000; *C*—₹ 1,15,000; *D*—₹ 1,20,000; Total of Balance Sheet—₹ 5,67,200.

[**Hint:** Change in profit-sharing ratio will result in loss of 6/24th to *A* and 2/24th to *B*; gain of 2/24th to *C* and 1/4th to *D*. Hence, the entry for adjustment of goodwill premium will be:

		₹	₹
C's Capital A/c	...Dr.	10,000	
Premium for Goodwill A/c	...Dr.	30,000	
To *A*'s Capital A/c			30,000
To *B*'s Capital A/c			10,000.]

5. Gain (Profit) on Revaluation—₹ 6,300; Capital Accounts of Jain—₹ 85,600; Gupta—₹ 71,700 and Mishra—₹ 52,433; Total of Balance Sheet—₹ 2,49,733.

[**Hint:** *Calculation of Mishra's Capital:* Combined Capital of Jain and Gupta (after adjustments) for 3/4th share = ₹ 85,600 + ₹ 71,700 = ₹ 1,57,300

New Firm's Total Capital = ₹ 1,57,300 × 4/3

Mishra's Capital for 1/4th share = ₹ 1,57,300 × 4/3 × 1/4 = ₹ 52,433.]

6. Gain (Profit) on Revaluation—₹ 9,600; Capital A/cs: *A*—₹ 61,750; *B*—₹ 31,650; *C*—₹ 23,350; Total of Balance Sheet—₹ 1,46,050.

[**Hint:** Capitals of *A* and *B* after all adjustments are ₹ 61,750 and ₹ 31,650 respectively. Hence, the combined capital of *A* and *B* is equal to ₹ 93,400 which is 4/5(1 – 1/5) of the capital of the firm.
Hence, *C*'s 1/5th share in the capital will be: ₹ 93,400 × 5/4 × 1/5 = ₹ 23,350.]

7. Revaluation Loss—₹ 15,000; Capital Accounts (31.3.2020): Hari—₹ 67,500; Ram—₹ 60,000; Suraj—₹ 25,500; Balance Sheet Total—₹ 2,55,000.